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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHIGNTON, DC 20268-0001

Statutory Review of the System	)	Docket No. RM2017-3
For Regulating Rates and Classes	)	
For Market Dominant Products	)	

COMMENTS OF THE DATA & MARKETING ASSOCIATION
And THE DMA NONPROFIT FEDERATION
(March 1, 2018)

The Data and Marketing Association and the DMA Nonprofit Federation (collectively "DMA") appreciate the opportunity to comment on the Postal Regulatory Commission (PRC) Notice of Proposed Rulemaking for the System for Regulation Rates and Classes for Market Dominant Products, Docket No. RM2017-3.

DMA is the community that champions deeper consumer engagement and business value through the innovative and responsible use of data-driven marketing. Its membership is comprised of leading data innovators, marketers, agencies, and nonprofit organizations representing the entire marketing ecosystem.

DMA and its members believe that the PRC's proposed rule: 1. Exceeds the directive in 39 USC Section 3622; 2. Removes the cost control incentive of the CPI cap; 3. Fails to consider all objectives and factors in the Act; 4. Creates an anti-customer incentive for productivity improvement and achieving service commitments; 5. Imposes "reimbursement" that is unreasonable; 6. Fails to consider Postal Service cost containment failures, and ignores cost containment for underwater products; and, 7. Overlooks the statutorily imposed preference for nonprofit mail, the press, and educational, cultural, informational and scientific mail. The proposal is fatally flawed. DMA has joined with the American Mail Alliance (AMA) filing, fully agrees with its content and incorporates it in these comments.

The proposal exceeds the review mandate of 39 USC section 3622 (d)(3).

The PRC analysis supporting the proposed rule focuses on 39 USC 3622 (b)(5). That section is one of nine objectives any rate setting system should achieve. As section 3622 (b) begins:

> *Such system shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others:*

Objective 5 (39 USC 3622(b)(5)) states:

> *(5) To assure adequate revenues, including retained earnings, to maintain financial stability.*

In reviewing Objective 5, the PRC looked at three separate tiers of Postal Service (USPS) financial stability, short-term, medium-term and long-term. The PRC stated that financial stability as defined by Objective 5 meant that all three tiers must be met. PRC Order 4258 at 27, 28. Only short-term financial stability was achieved. *Id.* at 28. Therefore, the PRC proposed these changes to the rate setting system. Nowhere does Objective 5 require this three tier review. The current rate setting system has achieved short-term financial stability for USPS. The Postal Accountability and Enforcement Act (PAEA or the Act) has been a success.

39 USC 3622 (d)(3) established this ten year review of the rate setting system by the PRC and allows the PRC as appropriate thereafter to further review the rate setting system. Thus, the PRC was not compelled to adjust the system for medium- and long-term effects at this time. It is in the PRC's power to review the system when needed. The PRC went a step too far. Abrupt changes in the system are not healthy, and the PRC could and should have avoided them with its review authority. Moreover, the PRC, in this proposal, did not adequately assess the financial strength of the USPS. First, it simply brushed aside the fact that USPS real estate assets are undervalued. These are phenomenal assets that are valued on USPS books at the cost of purchase of land and construction of facility less depreciation at the time when acquired. They are not valued at current market prices. Many of these real estate holdings are in prime locations in major US cities. Further, the PRC does not adequately account for the significant funds USPS has in its pension and retiree health benefit accounts. USPS is the gold standard for American business for its funding of retirement obligations.[1] The losses incurred by USPS in the ten years since the passage of the Act are the result of a prepayment schedule for retiree health benefits. USPS has failed to make those payments in the past few years to no consequence to customers because there were adequate revenues to fund its ongoing operations (including fully funding the retirement benefits for current employees and retirees). The PRC through this rulemaking seeks to impose a consequence on USPS customers.

None of this is required by Objective 5.

The proposal removes a central incentive of PAEA.

The PAEA rate setting system provided not only rate stability and avoidance of rate shock, but also a financial incentive to USPS to control costs. USPS has authority to raise annually postal rates for market dominant products by the CPI regardless of costs and to retain any earnings. Thus, if USPS controls costs, it would increase its retained earnings. This system replaced that of the Postal Reorganization Act of 1970. The 1970 Act system was based on the cost of service—how much would it cost USPS to provide the service and set rates to recoup that cost plus a contingency allowance.

We believe the PRC proposal is a step backward towards that cost of service system. It found that PAEA system had not afforded USPS the ability to generate revenues beyond those needed for operations in order to establish reserves to meet what the PRC called "medium" - and "long-term" financial goals. The PRC is, in essence, allowing USPS to raise postal rates to meet these newly invented goals. Cost cutting incentives are gone. (Below is a discussion of the productivity and service standard incentives.) What does this proposal say to USPS

[1] Many American businesses have abandoned worker retiree benefits altogether.

management? “If you cannot control costs to keep rates below inflation, the PRC will allow USPS to break the CPI cap in its next review.” What does this proposal say to postal employees? “When negotiating for wages and benefits, do not be concerned about the financial stability of USPS because in the next rate system review the PRC will allow USPS to break the CPI cap.” What does the proposal say to arbitrators if wage negotiations fail? “Do not be concerned about the financial stability of USPS because in the next rate system review the PRC will allow USPS to break the CPI cap.” What does the proposal say to USPS customers? “You lose. If USPS controls costs, postage still rises by CPI. If USPS does not control costs, PRC will allow USPS to break the CPI cap.” It is hopeless for USPS customers.

The PRC should not create a rate setting system that negates the CPI cap financial incentive to control costs. The proposal sets a terrible precedent for cost control especially when the PRC found that USPS failed to use existing authority to maximize cost reductions and operational efficiencies. *Id.* at 28.

The proposal fails to consider all the objectives and factors in the Act.

Creating the new rate setting system proposal the PRC cites only Objectives 1, 3, and 5. 39 USC 3622(b)(1),(3),(5). The main emphasis of the justification in the proposal is Objective 5, financial stability. Among the factors listed in 39 USC 3622(c) which the PRC is required to “take into account” are:

> *(3) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;*
>
> *(4) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;*
>
> *(11) the educational, cultural, scientific, and informational value to the recipient of mail matter.*

None are not part of the PRC explanation. But all those factors and all the objectives must be considered. The PRC has created a hierarchy of the objectives and factors in this proposal which is inconsistent with the Act.

The proposal creates an anti-customer incentive for productivity improvement and achieving service commitments.

The PRC incentives for improved productivity and meeting service standards are not customer friendly. USPS should be working to maximize productivity improvement to meet Objective 1. With a CPI cap, reduction of costs through productivity improvement would help USPS financial stability as rate authority would be unchanged due to lower costs. The PRC proposal would add an additional reward for USPS for productivity improvement. On the service standard issue the proposal is even more illogical. Customers pay USPS to deliver mail within the service standards, but the PRC wants to reward USPS for doing the task for which it has been paid by the customer by increasing the price paid by the customer. Why should customers pay a reward for delivery service the customers have paid for already? This makes no sense to DMA and its members. USPS should be constantly working to improve productivity and provide the service for which it has been paid. Customers should not be saddled paying a reward to USPS for doing its job. In fact, USPS has struggled to meet its published service standards, and customers have no recourse at USPS due to its failure to provide the service for which it has been paid.

The 0.75 percentage point above CPI productivity "incentive" also rewards USPS for maintaining its current productivity record, a record that allowed flat-shaped processing costs to increase 2.6% per year for the last eight years. *Id.* at 78. Rewarding USPS for "improving" productivity wherein costs rise faster than inflation is wrong—a reward for failure. The productivity factor on which this incentive is measured, total factor productivity, does not account for all the added mailing requirements that USPS has imposed on its customers. Those added requirements are "designed" to shift costs from USPS to the customer which "improves" USPS productivity. In this way customers would have costs added to their mail preparation and then face higher postage costs to fund the USPS productivity reward.

These two above CPI rewards, if earned, become part of the rate base for all future postage increases. Thus, USPS could improve productivity in year one and then have an abysmal productivity record for the next two years, but the year one 0.75 percentage point above CPI rate would be compounded and still paid in years two and three. The same would hold true for the 0.25 percentage point service standard reward. That is a lose-lose result for customers.

If customers must pay for productivity improvements and for achieving service standards, those customers should be paid if USPS falters and the PRC proposal has no disincentive for failure to achieve the rewards. However, customers will forever have to pay for achievement in any year. That simply is not a fair bargain. In fact, one could imagine the following scenario (this is one of many):

> In year one USPS management has a significant effort to improve productivity and achieves the 0.75 percentage point reward. Meanwhile in year one meeting service standards is not achieved. In year two management makes a push to meet service standards and achieves them. However, productivity slipped. Customers would still pay the 0.75 percentage point reward from year one and now pay the 0.25 percentage point reward for year two. In year three productivity is the push—year four service standards, etc. Customers would continue to pay year after year the rewards earned in previous years.

That is an unbelievable burden upon customers.

One solution to avoid such a scenario would be to include a 0.75 percentage point and 0.25 percentage point, respectively, reduction in the CPI cap if USPS fails to achieve either productivity improvement or meeting service standards.

Another solution would be to have the reward be a bonus for the year and not included in the rate base.

> If in year one USPS earns its productivity improvement, rates could rise 0.75 percentage points above CPI, for this example CPI is 2% every year. That 0.75 percentage point reward would vanish in year two. If USPS failed to earn the reward in year two, the average increase would be rates from year one less 0.75 percentage point increased by 2%. If USPS earned the reward in year two, the average increase would be rates from year one less 0.75 percentage point increased by 2.75%. The elimination of the reward in the next year would be a requirement. USPS could not avoid an increase, bank the CPI, and maintain the postage rates based upon the reward. In such a case, USPS would be required to decrease postage.

In this way, rewards would be a year-to-year phenomenon, similar to a pay bonus rather than a wage increase. DMA believes these rewards are ill founded, but the PRC, if it promulgates them, should not make them permanent. In addition, to avoid the scenario wherein USPS improves productivity at the expense of service, there should be no productivity reward in any year if service declined in that year, or *vice-versa*.

DMA has two final comments on the service standard reward. First, if USPS reduces service standards, as it has in the past—First-Class next day delivery, for example—any service standard reward should vanish forever. USPS should never be rewarded for meeting a reduced service standard. Second, USPS does not have a service measurement system in place that covers all the mail. USPS fails to adequately measure service performance for at least 20 percent of mail. DMA believes that it is likely the service provided the non-measured mail is worse than for mail which is measured. There should be no service reward without complete measurement.

The proposal imposes "reimbursement" that is unreasonable.

As more fully explained in the comments of the AMA, the losses incurred by USPS in the past ten years are the result of the Congressional mandate to fully fund retiree health benefits over that ten year period. That is not a failure of the rate setting system, and no change in the system is warranted. However, the PRC solution would impose a 2 percentage point increase over CPI for five years. Looking at recent history that 2 percentage point increase amounts to doubling the rate of inflation. Such an increase, if promulgated by the PRC, is too much. Double inflation increases would be a turning point for the mailing industry as it adjusts to the digital economy. Moreover, the five year timetable for this rate reimbursement is based upon the PRC's next planned review of the rate setting system. There is no requirement for a five year review in the Act. The PRC could initiate a review in ten years or tomorrow. The five year term is arbitrary as is this unreasonable 2 percentage point above CPI system adjustment.

Although some have mused that mail volumes did not collapse when USPS was charging exigent rates, that analogy is flawed. As pointed out in the AMA comments, exigent rates were temporary. Customers knew that and adjusted to the temporary increase. The increases proposed by the PRC are not temporary. The customer adjustment will be based upon a permanent, compounded, double the rate of inflation postage increase. Moreover, during the temporary exigent rate period, USPS customers drastically reduced other mail preparation, design, paper and printing costs to maintain volume. Those cost cutting opportunities are no longer available. The subsequent volume damage will be permanent. In addition, a recent survey of large mailers sponsored by the EMA Foundation conducted by Info Trends found that with postage increases 3 percentage points above CPI, 45% of large mailers would reduce mail volume at an average of 4.3%. Such a volume loss by USPS' largest customers caused by the PRC proposal would undermine, not strengthen, USPS financial stability.

Finally, the proposal has no provision to cease and rescind immediately the "reimbursement" of these CPI cap busting rates if there is legislation that would eliminate or significantly reduce the unfunded retiree health benefit liability or if economic factors do the same. If either of these events occur, customers should not be required to fill USPS coffers. Cessation and rescission apply beyond the five year term as customers never should be burdened with costs USPS does not incur.

The proposal fails to consider USPS cost containment failures, and ignores cost containment for underwater products.

The proposal provides USPS with added revenue to cover "losses" over the past ten years. There is no consideration of USPS cost cutting efforts save the productivity incentive discussed above. There have been failed efforts by USPS to contain costs, and the proposal ignores them to the detriment of customers. Any future failures would simply be reimbursed by the PRC in the next system review by busting the CPI cap.

Consider one glaring cost cutting failure by USPS management. Immediately after raising postage for flat-shaped mail by 25% in 2007, management purchased multi-million dollar Flat Sequence Sorting Machines (FSS). Flat-shaped mail volumes needed to efficiently run the FSS never materialized due to the 25% postage increase. Thus, the projected productivity improvement also never materialized, and, as the PRC found, flat sorting costs continue to rise faster than inflation. *Id.* The proposal simply allows USPS to increase those rates above inflation.

The vast majority of underwater products are products of flat-shaped mail which is not surprising due to the failure of the FSS system. The PRC proposal not only fails to examine the underlying cost cutting failure for underwater products, but also rewards USPS for that failure. Underwater products in underwater classes will have postage increases 2 percentage points higher than the already inflated cap in the proposal. Underwater products in classes that are not underwater must have postage increases that are 2 percentage points higher than the class average which will itself be far, far above CPI under the proposal. But with no review, no disincentive, no penalty, flat-shaped processing costs will continue to rise higher than inflation. This underwater problem will continue, and the proposal will not prevent it. The solution is rather simple—penalize USPS for cost cutting failures and do not reward USPS for them. USPS management will be on notice to channel resources to fix the problem quickly.

The proposal overlooks the statutorily imposed preference for nonprofit mail, the press, and educational, cultural, informational and scientific mail.

There is no provision to meet the requirements of 39 USC 3622 (c)(11), 3626. The press, educational institutions, hospitals, nonprofits, etc. are ignored. The proposal fails to examine the effect of these inflation busting postage increase on these customers as required by 39 USC 3622 (c)(1). This is a grave oversight—fatal, in fact, to DMA.

Conclusion

DMA believes the proposal should not be promulgated. It is a step backward to cost of service pricing under the guise of a rate cap. It removes the incentive for USPS to cut costs. It fails to include all the objectives and factors in the Act. We believe those are fatal flaws. Moreover, the proposed performance and service rewards are flawed and anti-customer.

However, if the PRC determines that an adjusted rate setting system should be implemented, the DMA recommends the following:

- If USPS no longer must fund part or all of the current retiree health benefits liability by statute or economic factors, the CPI cap busting rates allowed by the PRC proposal must immediately end and be rescinded. However, those unreasonable CPI cap busting rates should never be implemented. USPS can meet its financial responsibilities under the CPI cap.

- Productivity and service bonuses should not be allowed as USPS owes its customers the service for which they have paid and any productivity improvement should be passed to customers *via* lower postage

- USPS should not earn a productivity award in any year if service performance declined and *vice-versa*.

- If USPS reduces service standards for any product, the service performance award should be eliminated forever.

- USPS must establish a public reported service measurement system that measures all mail before any service performance reward may be implemented.

- If USPS fails to implement within the next year cost cutting programs for underwater products, any surcharge should not be considered.

Again, DMA appreciates the opportunity to present these comments.

Respectfully submitted,

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